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New York (State.)

New York legislative report on taxation 1916

[New York]

[1919?]

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New York Legislative Report on Taxation — 1916

SUMMARIZED
for the
LEGISLATURE OF 1919

The New York Joint Legislative Committee on Taxation, 1916, reported:

"Our present law is based upon the theory that earning power is fairly represented by property and especially real property.

"Even a superficial knowledge of business of today discloses the fact that quite the contrary is true.

"As a result of this inconsistency between the law and the fact, we have permitted an important part of our well-to-do citizens to grow up and enjoy large incomes, and therefore large tax-paying ability, without actually requiring them to bear their share of the burden.

"Were the people of New York once aroused to the full extent of evasions under the present law, another year could not pass without an important tax reform." (Page 28.)

The Committee understood that it was appointed "to investigate the relative burden borne today by different classes of property and persons; to devise ways and means of doing away with such inequalities as exist, more particularly in so far as the personal property tax is concerned, both in its application to individuals and to corporations; and to present to the Legislature such a plan as in its judgment will tend to equalize present, as well as future, tax burdens, by the establishment of a broader tax base and a fairer distribution of those burdens." (Page 3.)

NOTE

The valuable statements and tables as to the large and increasing cost of State and local government in New York are not reproduced here as they are now out of date, and *conditions have become even worse than those then deemed disastrous,* for reasons too well known to require discussion.

The conclusions of the report are here given verbatim, in form for quick reference.

Legislators and taxpayers would do well to consider this admirable report and its recommendation of a general income tax, in connection with the more recent outline of a model plan for State and local taxation prepared by eminent tax officials and experts for the National Tax Association. The plan has been endorsed by the New York State Tax Association and the tax committee of the State Conference of Mayors.

This report was signed by Senators Ogden L. Mills, Chairman, and Archie D. Sanders; Assemblymen Edward A. Everett, H. Edmund Machold and William W. Chace. A minority report, in favor of relief only by improving existing laws and imposing new levies on corporations and inheritances, was presented by Senator John J. Boylan, Assemblymen Charles D. Donohue and William J. Gillen. The counsel to the committee were Messrs. Henry M. Powell and Walter Lindner. The investigation was in charge of, and much of the majority report was written by, Prof. H. A. E. Chandler of Columbia University.

L. D. W.

Peculiarities of N. Y. Law

The New York tax system contains several peculiar features that differentiate it in a striking manner from nearly every other tax system in the United States. Several of these peculiarities are of special interest because they are unquestionably accountable for some of the weakest spots in the present tax law. (Page 21.)

(1) Most states tax tangible personal property of residents where located, but New York State taxes all tangible as well as intangible personalty only at the legal domicile of the owner, whether it be an individual or a domestic corporation. (Page 21.)

(2) Deduction of all debts not simply from credits, but from all personalty, is not the rule in other states as it is in New York.

(3) The third peculiarity is that public service corporation franchises, or so-called "special franchises," are treated as real estate. (Page 22.)

(4) New York is the only state in the Union that has not had a complete listing system. But the uniform failure of all listing systems, however essential to the assessment of personalty, minimizes this defect.

(5) Our peculiar definition of "personal property" exempts good-will and the courts have been held it to be untaxable. Capital stock is also exempt. The mercantile and manufacturing tax now reaches it to some extent—to the extent of 3% of *net* earnings.

(6) The "most illogical corporation law in America" and the also famous section 12 on taxation of the personal property of corporations, with all their complexities and confusion are still with us.

[NOTE: There have been partial improvements for a few taxpayers injected since the Mills report by the 3% net income tax for certain corporations.] (Page 23).

Faults of the System

The faults of the system are not limited to its peculiarities. New York, like every other state in the Union, has suffered the inequities that arise from the outgrown general property tax, as follows:

(1) Utter failure of that part of the personal property tax that is still left under the general property system. (Page 23.) *It should be eradicated* as soon as possible. (Page 24.)

(2) Lack of adequate provisions for administration. The present law was designed to deal with conditions that no longer exist—a simple society in which most property was tangible and in which ability to pay was roughly measured by the amount of tangible property owned by each.

It was designed for business units of local scope. Any system which leaves in the hands of the local assessor the assessment of that part of nation-wide business enterprises that happens to be located in, or to traverse his little district is, of course, nothing short of mediaeval. (Page 24.)

In whatever direction reform in the New York system of taxation shall come, it is clear beyond the shadow of a doubt that to be successful it must be accompanied by improved administration. (Page 25.)

(3) Taxation of personalty at owner's domicile, is subversive of all equity as between localities—the locality that supplies fire and police protection must yield the right to tax the property so protected to other localities supplying none of these protections. Thus, an individual merchant or corporation doing business and actually residing in the city of Rochester may be obliged to meet, in so far as local trade is concerned, the competition of a rival who is free from all the taxation on personal property,—if that rival resides in the adjoining town of Brighton, or further away in Esopus. (Page 25.)

(4) Needless complexity and ambiguity of the method of taxing corporations. (Page 26.)

Not only do large groups of wealth escape taxation entirely, but many individuals most able to pay taxes and enjoying great privileges within the state cannot be reached under the present law. (Page 26.)

Present Sources Inadequate

It is inconceivable that the communities of the State should continue to raise additional revenue by increasing year by year the rate of the direct tax. There are not less than four important reasons why it would be inequitable as well as unwise from the point of view of the stability of certain lines of business to place additional burdens upon that property bearing the general property rate. (Page 26.)

(1) A horizontal raise always accentuates existing inequalities. Under our system, the situation is even worse because a horizontal raise is always limited to only part of the taxable base, a large number of sources having been taken from the general property tax.

(2) *Great masses of wealth are now escaping,* in part or in whole, from paying their fair share of taxation; and furthermore, *these sources cannot be reached under the present system.* And in this connection it should be noted and emphasized that the present high rates of the general property tax are due principally not to the usually great expenditures of money in the State of New York, nor to great extravagance, but to the fact that so much wealth is totally escaping from taxation. In other words, the part which escapes has loaded its burden upon the part that is caught. *Were the people of New York once aroused to the full extent of evasions under the present law, another year could not pass without an important tax reform.*

"What are the principal sources that are now escaping? We have already mentioned intangible personalty. Under this term is grouped the greatest earning power, and therefore, the greatest ability to pay taxes in America. And yet under our present law it is impossible to reach an important part of this wealth. (Page 28.)

Another fruitful source of tax evasion is found among those wealthy citizens of New York who shift their legal residence for the purpose of evading taxes. (Page 28.)

A still more important source that escapes almost all taxation is that of foreign corpora-

tions doing large amounts of business in the State of New York. It is argued by some that foreign corporations ought not to be taxed to any extent in this State. However, a careful study discloses the fact that most of these corporations are foreign only in name, and that in reality they are domestic corporations with many of their plants located in the State. (Page 28.)

In addition to the above, there are several groups of wealth that are escaping from paying their fair share. Space does not permit the discussion of these in detail. *In summarizing it is sufficient to say that were proper and thoroughly possible means taken for reaching the sources which now escape, it would not be necessary to consider the doubtful results of increasing present rates. Present rates would not be increased; they would be decreased materially.* (Page 29.)

(3) Any considerable increase would threaten to disturb important business conditions. In this connection the real estate situation in New York City and other localities is already such as to cause apprehension. This statement should not be misunderstood. Much confusion has been injected into the discussion by the exaggerated claims of the real estate men, on the one hand, and of a group of radical social reformers, on the other. It should be noted that nothing but confusion can result from talking of real estate in the aggregate. (Page 29.)

There are large sections of the city of New York, as well as parts of the State at large, where an increase in the tax rate might constitute nothing short of confiscation. Indeed, *the present high rates upon real estate have already, through the reduction of net income, actually destroyed capital value.* (Page 29).

In summarizing it should be clearly borne in mind that the injustice of the present system lies not in the fact that it bears heavily on all real estate owners, but rather in the fact that it fails to discriminate and sometimes bears with such crushing force upon those who are least able to pay. (Page 30.)

Failure of Personalty Tax

During the last fifty years the ratio of personal property to real property has greatly increased, the ratio of taxable personalty to taxable realty has greatly increased, and the ratio of personalty taxable under the general property tax to the total assessment under the general property tax has increased. The actual assessment of personalty on the other hand has decreased from 25½ per cent to 3¾ per cent. (Page 68.)

Reasons for this collapse of the general property tax as to personal property, both tangible and intangible, are

(1) **Inequality of Assessments.** (*a*) *As between towns.* It is notorious that in some towns personal property is assessed at something like true value, whereas in others no attempt whatsoever is made to reach the personal property of either corporations or individuals, or if it is reached, it is assessed at a value insignificant as compared with true value. This has a tendency to produce throughout the State "isles of safety" where both individuals and corporations, by establishing a nominal residence, and by the payment of a small or nominal tax, are enabled to escape their proportion of the taxes needed where they actually reside. (Page 41.)

(*b*) *As between citizens* of the same town. The system is practically one of self-assessment, under which the dishonest man who is willing to swear off his taxes, does so at the expense of the honest man whose conscience does not permit him to do so.

(2) The personal property tax at a general property rate, let us say, 2 per cent, is **confiscatory and an actual incentive to dishonesty.** Two per cent is the equivalent of 50 per cent of the income of a 4 per cent bond, and no country in the world in normal times has or can successfully impose a 50 per cent income tax. The taxpayer will not submit to it, particularly when he knows that thousands of fellow citizens, in many cases with larger incomes, are actually evading its payment.

(3) **The Theory** underlying the general property tax is that both real and personal property should be taxed at the same rate and on the same basis. Without, at this time,

discussing the soundness of this particular theory, as a matter of practice, real estate bears practically the entire burden, while personal property, though theoretically liable, fails to contribute its share.

(4) **Deduction of debts invites fraud and evasion,** yet not to allow deduction of debts is in some cases double taxation. As has been said, "Individuals should be taxed on what they own, not on what they owe." This, of course, is not true in the case of many corporations that obtain most of their working capital by issuing bonds.

(5) The personal property tax is **unequal** as between different grades of property. It falls with equal weight upon property which is unproductive, yielding only small income, or a very large return.

(6) **Property no longer a true test of ability to pay.** In a simple agricultural community, where personalty is for the most part tangible and visible, property furnishes a fairly equal measure of a man's ability to contribute to the support of government; but under modern business development this is by no means the case. Take the case of the merchant with a large turnover and a comparatively low profit. His ability to pay taxes is by no means the equal of that of the merchant with a small stock of goods, a rapid turnover and large profits; yet under the personal property tax the former rather than the latter will pay the larger tax. (Page 42.)

(7) Personal property under modern conditions consists for the most part of securities, credits and other intangibles, **easy of concealment,** and which cannot be discovered without the co-operation of the taxpayer himself—a co-operation which the taxpayer declines to furnish, and which experience has demonstrated cannot be compelled. Moreover, the large accumulations of wealth in form of intangibles are usually concentrated in the great cities under conditions which make it well-nigh impossible for the assessors to locate the owners. (Page 43.)

(8) The great number of exempt securities makes it possible for the wise investor lawfully to escape personal property taxation. (Page 43.)

Injustice in Personalty Tax

All semblance of justice and equity has long since left the personal property tax, which has been suffered to remain on our statute books because of the widespread apathy and ignorance of the public in regard to taxation, and because of the fact that it has not, generally speaking, been enforced. (Page 43.)

(1) *As Between Tangible and Intangible Personalty.* Everywhere the result is the same—not only is a much larger proportion of tangible property reached, but that proportion reached bears a much higher rate of taxation as a result of the escape of intangibles.

The inequity is further accentuated by the fact that those most able to pay have their wealth largely invested in intangibles and that those least able to pay have their wealth largely invested in tangibles. (Page 44.)

(2) *As Between Poor and Wealthy.* Not only do the poor and those in only moderate circumstances have their wealth invested in easily seen and easily taxed tangibles, but the kind of tangible personalty in which the poor man invests his money, whether it be in his household effects or in his small business, is of such nature that the ordinary tax assessor is familiar with it, and can therefore assess at well-nigh its true value. (Page 44.)

Large investors invest in tax-exempt securities, while the small investors, particularly women, are apt to invest in taxable bonds. (Page 45.)

(3) *Concerning Widows and Orphans, and Trust Estates.* If there is one group of property which should escape with reasonable taxation, it would seem to be that property, the income from which is set aside for the support and education of those who have been deprived through death of the head of the family, viz., the widows and the orphans. When the chief bread-winner dies, a record of his property must be filed in the probate court, where it is easily accessible to the tax assessors. Here it is caught and taxed, while similar property held by others is untaxed. Were it taxed at only a fair rate, it would still be questionable whether this property ought not to be partially exempt. However, it is not taxed at a fair rate, but at a rate which makes the personal

property tax in this case one of the most barbarous to be found in any country. Cases are frequent where as high as 25 to 50 per cent of the total income set aside for the support of widows and orphans is taken by this tax. (Page 45.)

(4) *As Between Farms and Other Forms of Wealth.* That the farmers bear a disproportionate share of taxation is generally known and accepted by most of the informed throughout the United States. It is not generally known by the farmers or the public at large, however, to what an extreme degree this disproportion is carried. (Page 47.)

It would seem that from per capita earnings manufacturers could afford to pay nearly 75 per cent more taxes than could the farmers. But the farmers pay 10 per cent of their net earnings and manufacturers only 2 per cent of their net earnings. (Page 52.)

(5) *Injustice as Between Various Types and Classes of Enterprises.* As the personal property tax is now levied in New York, it constitutes not only a serious impediment to the development of some businesses, but a constant annoyance to many branches of business. In the same type of business, the ratio of personalty to realty sometimes varies from 1 to 2, to 1 to 75.

In fact the present investigation discloses the fact that in general throughout the State of New York the personal property tax bears to business the relation of an unmitigated nuisance. Were the law fully enforced, it would drive business out of New York; with present sporadic enforcement it falls with inequality and injustice. (Page 54.)

(6) *As Between the Various Counties in New York State.* Inequalities in the assessment of real estate are partly remedied by equalization. With personalty, however, all inequalities remain, because the board of equalization does not equalize personal property, but accepts the returns of the various counties. Thus the more efficient the personal property tax is levied in any county, the higher the percentage of the direct State tax that county is required to pay. In other words, the present law penalizes every county in proportion to its efficiency in enforcing the law. (Page 54.)

Listing of Personalty

Every state in the Union, except New York State, has had the listing system.

It has been common with those acquainted only with the New York system of taxation, to suppose that the failure to collect the personal property tax in New York was due to the lack of the listing system. An examination of the results in the states which have the listing system discloses in some of them a condition much worse than has ever existed in New York. (Page 143.)

Assessors have had every power necessary to inquire into and to gain knowledge of the ownership of personalty, every inducement has been offered to the assessors and to private citizens to ferret out personal property, yet in every case (with the exception of one or two temporary successes) the result has been failure to secure honest and complete listing. (Page 143.)

The most notable result obtained from these drastic measures has been, not the listing of a large proportion of intangible personalty, but widespread perjury.

The reports of practically every tax commission that has investigated the problem disclose the same results, viz., that the listing system in itself is not a remedy for the present difficulty with the personal property tax. (Pages 143, 144.)

There is no need to continue to dwell on the shortcomings of the listing system. We are of opinion that it cannot be made to succeed; that its adoption would be highly detrimental to the best interests of the State; that it is contrary to all our traditions, and that public opinion would not sanction its adoption. (Page 148.)

The Increase in Budget

Unless the people of the State desire a complete change of public policy, and are prepared to limit the activities of government, there is little likelihood, with the growing population and with the increased complexities of modern life, of any material decrease, no matter what administrative economies may be effected. (Page 11.)

This is borne out by the experience of other states and of the Federal government and of all foreign countries that have accepted modern democratic reforms with the new demands which they make upon government. (Page 11.)

A careful study shows that there has been a marked upward tendency in practically all of the cities, a tendency so universal that it cannot be fairly attributed to governmental extravagance. The increased expenditures have been incurred in response to the demands of the citizens of the localities for better service, and for the assumption by the municipal government of duties unthought of by previous generations.

There are but few cities in the State that in recent years have not improved their lighting systems, repaved their streets, constructed new sewers, built school buildings of the most modern type, and in general undertaken a comprehensive system of public improvements which, however desirable they may be, and however they may add to the comfort and enjoyment of the inhabitants, necessarily mean an increased burden to the taxpayers.

As a result, the tax rate is so high as to preclude the effective administration of the personal property tax, and the full weight of the increase has fallen on the owners of real estate. (Page 12.)

In the majority of the up-state cities, if the cost of government continues to increase during the next decade at the rate that it has in the last, these cities will unquestionably face as serious a situation as now confronts the owners of real estate in the City of New York, unless in the meanwhile some measure can be devised to compel the owners of personal property to contribute their share. (Page 13.)

No More Indirect Taxes

The imposition of new and miscellaneous indirect taxes which, while yielding additional revenue, would not reach the great mass of personal property now escaping taxation, or equalize the relative burden borne by different classes of taxpayers and different forms of property, would not, in our judgment, meet the problem submitted to your Committee for solution. (Page 149.)

Moreover, our study has resulted in the conclusion that *the problem has become acute in the localities rather than in the state budget.* Two-thirds of all taxes are devoted to local purposes, while by far the greater proportion of future needs are likely to be local in character. (Page 149.)

The miscellaneous taxes proposed are for the most part unavailing, because

(1) The yield would be small.

(2) They are now relied on by the Federal government.

(3) They will not solve the personal property problem. Moreover, *real estate would have to pay, even to a greater extent than under the present system, all future increases in the cost of government.*

(4) New taxes for state purposes could be used to avoid any future direct tax, but *there is very grave doubt as to the wisdom of the further development of the separation of State and local revenues by the imposition of new indirect taxes.* Experience has shown that where local and state revenues are separated and indirect taxes supplant a direct State tax, in the course of a very few years the yield of the former is exhausted, and the State is compelled to return to the direct tax under conditions by no means as favorable as those which existed at the time of its abolition. Indirect taxes are not as severely felt as are the direct, and are open to the charge of leading to extravagance, rather than to economy.

(5) *To superimpose new forms of indirect taxation upon our present heterogeneous system might temporarily alleviate, but might also postpone, and would eventually impede a proper solution of the already confused problem which demands immediate action, rather than temorizing.* (Page 150.)

Substitutes for Personalty Tax

1—On Presumptive Income

This widely advocated plan is composed of three parts, viz.: a habitation tax, an occupation tax and a salaries tax, only one to be paid by any person.

This is primarily an urban tax and, therefore, not a state-wide substitute. Also, if income be the fairest test of ability to pay, why resort to outward signs, to approximation, to the indirect means of ascertaining the income when it is possible to do so by the direct method? As between the indirect income tax and the personal property tax there is much to be said for the former, but as between an indirect income tax and a direct income tax, the advantages are clearly with the latter. (Page 168.)

2—On Classified Property

A proposal to tax personalty with low rates on tangibles and intangibles.

This also, is superior to our present system, but is not adaptable to New York, as

(*a*) Necessary listing system will not be approved; (Page 183.)

(*b*) Local administration is wholly inadequate, but required by our present constitution;

(*c*) Sufficient revenue could not be obtained greatly to alleviate the burden now borne by real estate and other forms of taxpaying property;

(*d*) The whole modern tendency, particularly in the business world, is to get away from property as a basis of assessment, and to look more and more to income;

(*e*) It would in no sense solve our corporation tax problem. (Page 184.)

3—The Income Tax

No fairer principle of taxation can be adopted than that each man shall be called upon to contribute to the support of government in proportion to his ability to pay.....and, in turn, ability to pay is best determined by the income or revenue which a man enjoys. (Pages184, 185.)

Taxes are paid out of income. *All taxes have to be paid either out of income or capital.* To pay them out of capital is to destroy the future source of income, both to the individual and the state. If persisted in over a long period of time, they will wipe out capital itself. This principle has repeatedly been recognized in our various taxes.

We have taxed property in the belief that, in the main, it was a fair criterion of taxable income, and this was true when our property tax system was originally adopted in a simpler state of society.

To-day, property alone is not a complete measure of the total income enjoyed, and if the above enunciated principle be sound, it is necessary to abandon the indirect property method of reaching income, and to tax income directly. This conclusion has received widespread recognition.

There is hardly a civilized country today where the income tax does not make up an important part of the tax system. It is in use in nearly every country in Europe, notably in Germany, England, France, Austria and Italy. At one time every one of these countries had a personal property tax, but as its failure became recognized it was abandoned and today they all resort to the income tax. (Page 185.)

The income tax is not likely to be any more successful than the personal property unless adequate means of enforcement are provided. This fact was conclusively demonstrated by the earlier experiences in this country. However, *the Wisconsin experiment has proved beyond controversy that the income tax could be administered with complete success under a centralized system of administration and with reasonable provisions for its enforcement.* In this respect it merely confirmed what had amply been demonstrated in Europe. (Page 186.)

Effect of Federal Tax

There is no question that, in addition to the Federal income tax, personal property must contribute its quota to the support of other government. Is it better to impose a 2 per cent property tax on capital value, or to impose a 2 per cent tax on net income?

We can hardly assume that the State will continue to allow the personal property tax to remain on the statute books and to permit its evasion. And so, *the choice does not lie between no tax and some new form of taxation such as the income tax, but between a continuance of the present hopeless system, and some better and more equitable way of raising revenue. If such a latter plan can be devised, are we to reject it because it is already employed by the Federal government, and in order to avoid duplication, continue to tax the same property in a manner which we admit ourselves to be inequitable, and to be a failure?* (Page 205.)

The income tax is the only tax that will reach that great class of people who do business in New York City, enjoying all of its commercial and other advantages on the same basis as a citizen of the State, and who, under the present law, pay no taxes whatsoever. (Page 202.)

Gist of the Whole Matter

"Our present law is based upon the theory that earning power is fairly represented by property and especially real property. However, a superficial knowledge of business of today discloses the fact that quite the contrary is true.

As a result of this inconsistency between the law and the fact, we have permitted an important part of our well-to-do citizens to grow up and enjoy large incomes, and therefore large tax paying ability, without actually requiring them to bear their share of the burden. (Page 28.)

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Secretary:

Leo Day Woodworth
55 Liberty Street, New York

INTENTIONAL SECOND EXPOSURE

Effect of Federal Tax

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